Licensing of Intellectual Property under EU Competition Rules: the Review of the Technology Transfer Block Exemption Regulation

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The views expressed are those of the authors and do not necessarily represent those of the Commission.

Introduction

The topic of this session is the competition policy approach in other jurisdictions, in particular the EU, towards licensing of IP. I would therefore like to present to you the review that the Commission has recently started of the Technology Transfer Block Exemption Regulation (hereafter 'TTBE').[1]

The TTBE, for those unfamiliar with it, is the main EU antitrust Regulation dealing with licensing agreements. Article 81(1) of the EC Treaty prohibits agreements that prevent, restrict or distort competition. Article 81(3) allows for exemption of those agreements which confer sufficient benefits to outweigh the anti-competitive effects. The Commission can provide such exemption for an agreement in an individual decision after notification. But the Commission can also provide such exemption for a whole group or certain category of agreements. These group or block exemptions are provided in block exemption regulations, one of which is the TTBE. The TTBE block exempts certain pure or mixed patent and know-how licenses for the purposes of manufacture, use and commercialisation (Articles 1 and 10 TTBE). A block exemption provides a presumption of legality to the agreements covered by it. This presumption stands up in court and also protects against the application of national competition law and block exemption regulations are therefore an important instrument of legal certainty. The block exemption may be withdrawn for an individual agreement if it is considered that the agreement does not fulfil all the conditions of Article 81(3). But such withdrawal can only have effect for the future (ex nunc) and can only be done by the Commission and, under certain conditions, by national competition authorities.[2]

While the TTBE expires in 2006 the Commission adopted on 20 December 2001 a mid-term review report (hereafter 'the Report').[3] This Report represents the start of a thorough review of our policy towards intellectual property licensing agreements. The publication of the Report kicked off a public consultation process and my services are currently examining written comments on the Report. After examination of these comments the Commission may propose a first draft of new competition rules for the application of Article 81 to licensing agreements by the end of 2002. After proper consultation of Member States, the European Parliament, industry, consumer associations and other interested parties on these draft rules the Commission will adopt the new rules, which can however not be expected before the end of 2003.

The review of the TTBE is a further step in the modernisation of our anti trust rules. This modernisation started with a review of vertical distribution agreements, later followed by a review of horizontal co-operation agreements, in particular R&D and specialisation agreements. These reviews have led to a new generation of block

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1 Commission Regulation (EC) 240/96 on the application of Article 81(3) of the Treaty to certain categories of technology transfer agreements, OJ L 31, 9.12.1996, p.2-13.

2 The possibility for a national competition authority to withdraw certain block exemption regulations, including the TTBE, was created in 1999 by Council Regulation 1215/1999, OJ L 148, 15-6-1999, p.1-4 (see in particular Article 1(4)).

3 The Report is published as a COM document with the reference COM(2001) 786 and is also available on the internet at the following address: http://europa.eu.int/comm/competition/antitrust/technology_transfer/

exemption regulations and guidelines, less legalistic and clause oriented and instead based on a more economic approach of anti-trust issues.[4] In the current TTBE the benefit of the block exemption depends on a large number of complex formal requirements found in lists of 'white', 'grey' and 'black' clauses, working as a straitjacket for industry by defining positively what is covered by the block exemption. The new generation of block exemption regulations has done away with this prescriptive 'white' list approach. They provide more flexibility by concentrating on identifying what is not covered by the block exemption in (shorter) black/hardcore lists. These hardcore restrictions are not only not covered by the block exemption but are also unlikely to be exempted individually. By making that all other (undefined) restrictions are covered below a certain market share threshold these regulations provide flexible safe harbours.

But there are also other reasons why it is a good time to reconsider our views on the interaction between competition law and IPR law and on the application of competition law to the licensing of IPRs. Technology transfer activities have considerably evolved during recent years. It seems that more joint efforts and more complex licensing arrangements are now required to keep pace with the greater complexity of new technologies. In addition, licensing activities have become more global.

It is therefore not surprising that not only we are reconsidering our policy, but that also on this side of the Atlantic the same is done. We follow with particular interest these FTC/DOJ hearings on "Competition and Intellectual Property Law and Policy in the Knowledge-based Economy". Our respective reviews will give us an excellent opportunity to learn from each others' experiences and where appropriate to promote convergence.

Basic findings of the Report

Before adopting its Report, the Commission carried out a preliminary fact-finding that has shown that industry would be favourable to a review of the TTBE and insists on the need to proceed with a simplification and clarification of the current rules.

The Report finds that by using criteria relating more to the form of the agreement than the actual effects on the market, the TTBE entails four main shortcomings:
- Firstly, the TTBE is too prescriptive and seems to work as a straitjacket, which may discourage efficient transactions and hamper dissemination of new technologies.
- Secondly, the TTBE only covers certain patent and know-how licensing agreements. This narrow scope of application of the TTBE seems increasingly inadequate to deal with the complexity of modern licensing arrangements (e.g. pooling arrangements, software licenses involving copyright).
- Thirdly, a number of restraints are currently presumed illegal or excluded from the block exemption without a good economic justification. This concerns in particular

4 Respectively Commission Regulation n° 2790/1999 for vertical agreements (OJ L 336 of 29.12.1999), n° 2658/2000 for specialisation agreements and n° 2659/2000 for R&D agreements (both OJ L 304 of 5.12.2000) and the accompanying Guidelines on Vertical Restraints (OJ C 291 of 13.10.2000) and Guidelines on the applicability of Article 81 of the EC Treaty to horizontal co-operation agreements (OJ C 3 of 6.1.2001).

certain restrictions extending beyond the scope of the licensed IPR, for instance non-compete obligations (exclusive dealing as you would say) and tying. In terms of economic analysis, such restraints may be efficiency enhancing or anti-competitive depending on the competitive relationship between the parties, the market structure and the parties' market power.

- Fourthly, by concentrating on the form of the agreement the TTBE extends the benefit of the block exemption to situations which cannot always be presumed to fulfil the conditions of Article 81(3), either because the contracting parties are competitors or because they hold a strong position on the market. For instance, the grant of an exclusive license can have serious foreclosure effects when an exclusive license is granted to a dominant producer which prevents other companies gaining access to technology that might foster their market entry.

In addition the Report provides a critical analysis of the application and the policy approach underpinning the TTBE. It discusses in some detail how the TTBE applies to certain restraints such as territorial restrictions, customer restrictions, field of use and output restrictions, acknowledging a lack of clarity of the TTBE itself and a lack of consistency with the new generation of block exemption regulations. For instance, the Report observes that, when the parties to an agreement are in a vertical relationship, territorial restrictions and customer restrictions imposed on the licensees may produce similar positive effects (i.e. solving free riding and hold-up problems) and may produce similar negative effects (i.e. foreclosure and facilitating market partitioning). While this would suggest that territorial restrictions and customer restrictions should be subject to similar treatment, the TTBE covers (to a certain extent) territorial restrictions and excludes from its coverage customer restrictions. The Report raises also more specific issues such as the treatment of software licensing agreements and licensing pools which have become increasingly important for the development and dissemination of new technologies.

The role of competition policy

The Report points toward a policy approach stressing the complementary role of competition and innovation policies. At the highest level of analysis IPR and competition law are complementary because they both aim at promoting consumer welfare. The objective of IPR laws is to promote technical progress to the ultimate benefit of the consumers. This is done by trying to strike the right balance between over- and under-protection of innovators' efforts. The aim is not to promote the individual innovator's welfare. The property right provided by IPR laws is awarded to try to ensure a sufficient reward for the innovator to elicit its creative or inventive effort while not delaying follow-on innovation or leading to unnecessary long periods of high prices for the consumers. Unnecessary long periods of high prices will result when the innovation allows the IPR holder to obtain market power in the antitrust market(s) where the IPR is exploited and where the IPR protects this market power position longer than is required to elicit the innovative effort. Competition policy aims at promoting consumer welfare by protecting competition as the driving force of efficient markets and innovation, providing the best quality products at the lowest prices.

The relevant question is therefore not one of conflict but of complementarity and possibly adjustment in the individual case. To what extent should competition policy intervene and try to improve the balance produced by IPR law? On this question some general lines of agreement but also some marked differences exist between different jurisdictions.

There is agreement on the positive role, be it a small role, competition policy may play in forming IPR law ("competition advocacy"). Competition policy expertise should prove useful in helping to decide on issues like the correct scope and duration to be awarded under IPR law, i.e. in deciding ex-ante on the balance to be found in IPR law. An efficient competition policy like an effective IPR policy has every interest to keep scope and duration limited to the minimum necessary to elicit the inventors' efforts.

There is also agreement that competition policy has to play its normal role where IPR rights are used to produce an anti-competitive effect beyond the exploitation of the IPR rights, that is where the restrictions do not concern the exploitation of the IPR itself. For instance, the conditioning of licensing on the purchase of a non-patented product (tying) or on the imposition of a non-compete obligation (exclusive dealing) is to be dealt with under competition law. There is also general agreement that in such cases competition policy must take account of specific IPR characteristics in order to properly protect dynamic efficiency. For instance, a non-compete obligation may be required to protect the confidentiality of the know how transferred or to prevent the know how benefiting competitors of the licensor.

There is however less agreement as to what extent competition policy should interfere with the exploitation of IPR rights. This is true both for the exploitation and licensing by dominant and non-dominant companies. It is here that marked differences exist between the EU and US approach. As far as these differences concern compulsory licensing by dominant companies under Article 82, this is dealt with in another session of these hearings. Given the topic of this session this paper will only concern itself, like the Report, with the evaluation under Article 81 of restrictions in licensing agreements.

There is no question of principle: both in the US and the EU the competition rules can in principle apply to (restrictions in) licensing agreements. In the US this was evidenced in the past by the Nine-No-No's and currently by the principle underlying the US Antitrust Guidelines for the Licensing of Intellectual Property to treat IPRs like other property rights. In the EU it has been the Court of Justice of the European Communities which has always stressed the need to protect the fundamental principles of free movement and competition in the Community. It developed the distinction between the grant or existence of the IPR, which can not be affected by the rules of free movement and competition, and its exercise or exploitation, which can be affected by the free movement and competition provisions of the EC Treaty.[5] The TTBE follows the Court in this distinction.

5 Consten Grundig v. Commission [1966] ECR 299, p. 346. See also Parke Davis v. Probel [1968] ECR 55 and Deutsche Grammophon [1971] ECR 1147.

The relevant question is to what extent competition policy should intervene against restrictions in licensing agreements. As described in the Report in a comparison between the competition policy approach to licensing in the EU and the US, in general EC competition policy places more limits on the exploitation of IPR rights than US competition policy. The comparison points out the main differences but also the growing convergence.

The stricter EU approach concerns in particular restrictions concerning the exploitation of the IPR itself when contained in licensing agreements between non-competitors. A similar policy difference between the EU and the US is found in relation to vertical distribution agreements in general. The difference reflects the higher importance EC competition policy attaches to 'intra-brand' restrictions in general and territorial restrictions in particular.[6] Territorial restrictions are paid more attention because of the additional market integration objective which EC competition policy has. In general, the protection of intra-brand competition is considered important as distribution costs make up a substantial part of the end price of most products and competition between distributors may help to reduce these costs. It is considered that intra-brand restrictions such as RPM but also territorial and customer allocation may hinder competition to the detriment of consumers. It is also a recognition of the fact that the licensees may be in a horizontal competitive relationship. The Report proposes to harmonise the EU approach to licensing between non-competitors with the EU approach to vertical agreements in general as laid down in Block Exemption Regulation 2790/99 for vertical agreements. This would subscribe to the general principle that also underlies the US Antitrust Guidelines for the Licensing of Intellectual Property, to treat IPRs like other property rights.

The US Guidelines have led in general to a lenient policy towards intra-brand restraints in licensing agreements where the licensor and licensee are not competitors. While recognising the possibility that the relationship between licensees may be horizontal (§3.3) and that "licensees that are competitors may find it easier to co-ordinate their pricing if they are subject to common restraints in licenses with a common licensor…"(§4.1.1), the Guidelines do not seem to give much weight to such competition consequences. The Guidelines emphasise in various places (see for instance §2.3 - example 1, §3.1 and §3.3) that antitrust concerns can only arise when the licensing arrangement harms competition between companies that would have been competitors in the absence of the license. The test whether companies would have been competitors in the absence of the license can for most cases be broken down in three parts. The first part concerns the relationship between licensor and licensee, which is also used to classify the agreement as horizontal or vertical in nature. The second concerns the relationship between licensor and competing suppliers of technology (the issue of foreclosure). The third and most difficult part to apply concerns the relationship between licensees, where the answer depends on their access to competing technologies and products. In practice, as an enforcement choice, the test may therefore often be applied by concentrating only on the first two parts. As far as intra-brand restrictions are concerned this would narrow the test to the question whether licensor and licensee are

6 It is good to remember that what are usually described as 'intra-brand' restrictions can have also effects on 'inter-brand' competition. For instance, RPM does not only exclude intra-brand price competition but may also facilitate horizontal collusion between manufacturers or distributors.

in a horizontal relationship and, if not, asking whether the licensor could in principle have achieved the same restrictions through vertical integration. In contrast to this lenient approach the US Guidelines are however strict where it concerns intra-brand pricing restrictions, where, with certain narrow exceptions, it is said that the per se rule will be enforced against RPM also in the intellectual property context.

Some issues for discussion

The Report invites comments on a number of issues:

- Should the scope of the TTBE, which only applies to patents and know-how, be widened to cover also copyright, design rights and trademarks? This issue is of particular importance for a number of sectors including the software industry, which depends upon a chain of copyright licences for manufacture and distribution.

- Should a revised block exemption also cover licensing agreements between more than two companies such as licensing pools? Such arrangements have become increasingly important for industry, given the growing complexity of new technologies. In this respect, it can be observed that multiparty licences may be efficiency enhancing and pro-competitive, in particular where without all the patents contributed to the pool the exploitation of the new technology would not be possible. However, multiparty licenses may also have serious anti-competitive effects, especially when the agreement covers competitive technologies or where it requires the members to grant licences to each other for current and future technology at minimal cost or on an exclusive basis. In such circumstances, multiparty agreements may disguise a cartel, lead to foreclosure or reduce the parties' incentives to engage in R&D thereby delaying innovation.

- Should a revised block exemption adopt a more lenient approach to licensing agreements between non-competitors? Without excluding other possible options, the Report proposes a framework for a future regime where a clear distinction would be made in respect of licensing between competitors and between non-competitors. In fact, it is generally acknowledged that if the parties to an agreement are in a vertical relationship, i.e. are not competitors, exclusive licences are generally efficiency enhancing and pro-competitive. For instance, if the IPR holder does not have the assets for the production or distribution of the licensed products, it is more efficient to license to someone who does have these assets. The exclusivity may be necessary to protect the licensee against free riding on his investments or to create the necessary incentives for both parties to invest in further improvements.

  In the light of this, it is proposed that, as far as licensing between non-competitors is concerned, the future block exemption could cover restraints that do relate to the exploitation of the licensed IPR, such as territorial, customer and field of use restraints, subject only to a dominance threshold. Furthermore, it could cover restraints that do not relate to the exploitation of the licensed IPR, such as non-compete and tying, below a 30% market share threshold as Block Exemption Regulation 2790/99 does for vertical distribution agreements. The block exemption would include a limited hardcore list, in particular concerning pricing restrictions and possibly certain territorial restraints. It may also contain conditions which would exclude certain restraints from the coverage of the block exemption (severability). It should be underlined that, for the restraints that do not relate to the exploitation of the licensed IPR (e.g. non-compete obligations, tying), such a treatment would create coherence with Block Exemption Regulation 2790/99.

Compared with the TTBE, this would mean that certain restraints currently in the black or grey lists would be exempted up to a certain market share threshold. For restraints that relate to the exploitation of the licensed IPR (e.g. exclusive licenses and territorial restraints), the dominance threshold would only apply in case the restrictions fall within Article 81(1) in the first place, for instance in case of foreclosure. Also, as more limited hardcore list would apply certain restraints would no longer be per se illegal: this could allow coverage of quantity restrictions, certain customer restrictions and maximum and recommended prices. The hardcore list, while basing itself on Block Exemption Regulation 2790/99 for vertical agreements, should take account of the specific characteristics of licence agreements.

- Should a future block exemption adopt a more prudent approach to licensing agreements between competitors? Agreements between competitors may give rise to a number of competition concerns if the licence prevents competition that could have taken place between the licensor and the licensee absent the licence. On the one hand, exclusive licences will often lead to market sharing through the allocation of territories or customers, especially when the licence is reciprocal or the exclusivity extends also into non-licensed competing products. Production quotas agreed in licensing agreements between competitors may easily lead to a straightforward output restriction. On the other hand, under certain conditions, in particular in the case of licensing to a joint venture and in case of non-reciprocal licensing, the exclusivity may not only lead to a loss of inter-brand competition but also to efficiencies. To assess whether the negative effects on competition may be outweighed by the efficiencies, the market power of the parties and the structure of the markets affected by the agreement need to be taken into account.

  In the light of this, the Report proposes that, as far as licensing between competitors is concerned, the future block exemption could be limited by a market share threshold of up to 25%. In addition, it would contain a hardcore list for restrictions which directly or indirectly fix prices, limit output or sales, or allocate territories or customers and may have to contain a list of conditions which would exclude certain restraints from the coverage of the block exemption (severability). This would create coherence with Block Exemption Regulation 2659/2000 for R&D agreements. Compared with the TTBE this would mean a more nuanced approach for pooling arrangements, cross licensing agreements, licence agreements concerning joint ventures and for restraints that do not concern the exploitation of the IPR itself, such as non-compete and tying. These are restrictions which are presently either excluded from the TTBE or blacklisted. It would justifiably provide less protection to territorial restraints between competitors in exclusive licensing agreements.

  Above the mentioned thresholds it is proposed that guidelines will clarify competition policy, with appropriate references to the existing Guidelines on Horizontal Co-operation and Guidelines on Vertical Restraints.

Conclusion

While being open to all suggestions the Report outlines the above-mentioned possible framework for a new policy. It proposes to replace the current Regulation with a wide, umbrella-type block exemption regulation in combination with a set of guidelines. The scope of the new block exemption regulation would cover a wider array of patent and know-how agreements than the current Regulation. The question is also raised as to the appropriateness to include other IPR agreements, in particular copyright licensing agreements. Alignment is sought with the approach followed in the block exemption regulations for vertical and horizontal agreements by limiting the prescriptive character of the new regulation and by concentrating on a limited hardcore list and using similar market share thresholds to define safe harbours. It is suggested that a clear distinction should be made between licensing between competitors and between non-competitors.